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EMPLOYEE BULLETIN

EB No. 1350 20 March 1986

POTENTIAL TAX CHANGES TO FEDERAL RETIREMENT ANNUITIES

Reference: EB No. 1323, dated 26 December 1985

1. This employee bulletin provides an update to the reference concerning tax reform legislation under consideration by Congress and its potential impact on Federal retirement annuities. There are strong views in Congress on this issue, both for and against, including the provision to change the laws affecting taxation of pensions. At this point, there is still active debate and it is too early to predict what the final resolution will be.

2. The reference advised of the serious implications to Government employees that could result from enactment of a House-passed version of tax reform legislation. Proposals in the House bill would involve the taxing of Federal annuities from the date of retirement rather than the current system which permits a tax-free period until the retiree has received back the full amount of his or her contributions to the retirement fund. In the latter instance, this normally takes about 18 months. The logic behind the current provision is to avoid double taxation. The proposal under consideration also avoids double taxation, but calls for the use of actuarial tables to determine life expectancy after retirement and then prorates the tax exemption of the retiree's contribution over that period. For example, if the life expectancy was 20 years, 5 percent of the retiree's contribution would be tax free each year. The obvious implication is that the retiree would not have the initial tax-free period immediately following retirement to sell houses, stocks, bonds, and other investments to take advantage of a lower tax bracket.

3. The current House-passed proposal would make the provision to tax annuities effective for annuities starting after 1 July 1986. The Senate, on the other hand, is only just beginning to take up the tax issue, but their stated intention is to completely rewrite the House version. There has also been a resolution introduced in the Senate to entirely eliminate the House changes on taxing annuities. In addition, subsequent Congressional inquiries to individual Government agencies on the potential negative impact of such legislation indicates this is not a cut-and-dried issue. Thus, it still remains very much up in the air regarding what provisions, if any, will ultimately be enacted.

4. If legislation is passed, affected employees will have to review their individual circumstances and make a decision accordingly. Indeed, it may become a nonproblem if the Senate continues its strong debate. However, anyone who might want to consider retirement to avoid these changes, if enacted, should do some preliminary planning. This includes obtaining necessary information and forms to permit timely submission of retirement applications, preparing a Summary of Agency Employment, and making other tentative plans which would allow for retirement on or before the effective date of the legislation, i.e., retirement by 30 June 1986, if the House version is the final bill. Obviously, if no legislation is passed or a different effective date is chosen, an individual's plans could change accordingly. In the interim, some preplanning will facilitate whatever final decision is made.

5. The Office of Congressional Affairs and the Office of Personnel are following this issue very closely and will continue to keep employees promptly advised on the status of the legislation as it progresses through the Congress.

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